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## The Downward Pressure on Oil Prices

By WILLIAM M. BROWN and MAX SINGER

Many analysts have forecast a continuing upward pressure on international oil prices as a result of economic forces. Within a few months, however, spot prices for oil should no longer provide significant premiums above contract prices. This would indicate the disappearance of pressure on prices.

Barring new political shocks from any of the principal OPEC exporters, inflation-adjusted oil prices can be expected to follow a downward trend during the 1980s, parallel to that which occurred during the five-year period from January 1974 to December 1978.

Free-world, non-OPEC oil production has been growing 6% to 8% per year recently; available evidence indicates that it can maintain that rate until 1985, and possibly to 1990. Non-OPEC free-world production, which was only half of OPEC's in 1975, is likely to exceed it by 1985. Meanwhile, oil consumption has grown at less than 2% per year since 1973. In the early 1980s it is not likely to grow any faster, primarily because this year's spurt in prices will increase conservation efforts and contribute to slower economic growth. Also, world production of natural gas and nuclear power, as well as other oil substitutes, mainly coal in the U.S., is expected to increase faster than average energy consumption.

For these reasons the demand for OPEC oil in 1985 should be less than the 30 million barrels per day (MBPD) it has averaged since 1973, perhaps much less. Faced with declining demand OPEC nations could have trouble cutting production enough to hold real prices at their current high levels.

A recent study by the U.S. Energy Information Agency set an upper bound of 29 MBPD for 1985 non-OPEC free-world production. That was before the sharp increase in prices. Our projection of 28 to 32 MBPD is only a little more optimistic.

Many analysts may disagree with these estimates because they doubt that the recent trends in non-OPEC production will continue. This would be the same kind of mistake about projected oil supplies that government officials have made repeatedly during the last 100 years. In our assessment of the next five years Mexico and the U.K. each show a 1.5-2.3 MBPD growth in production; Norway and Canada 0.5-1.0 MBPD; and modest increases totaling 1.0-2.0 MBPD in other areas such as Egypt, Malaysia and South America. The potential for increased U.S. production will depend upon the taxes which Congress imposes on oil production — especially newly-discovered oil — and upon trends in environmental and other regulatory constraints. We estimate it from zero to 1.5 MBPD.

Recently, the CIA concluded that the European Communist bloc will not be able to produce enough oil to maintain even a very modest growth rate. That claim has been disputed by many European analysts as well as by Soviet officials. The latter insist that Soviet production will continue to climb until 1990. The CIA aside, the consensus among experts is that the Soviet bloc will not become net oil importers because of their potential for increasing both oil and gas production, as well as for conservation. There is little doubt, however, that China will emerge as a substantial oil exporter.

The event that triggered the 1979 oil-supply squeeze—the Iranian cutoff—evidently was followed by panicky attempts by many petroleum consumers to increase their fuel stocks. Thus, during most of 1979 substantially more oil was bought than was consumed, providing an "artificial" boost to prices.

We have estimated that about 500 million barrels of increased storage occurred, world-wide. That is a huge amount of extra oil to store in existing facilities. Nevertheless such stockpiling must come to an end as tanks become full; as that occurs the demand for imported oil must fall. Our calculations, admittedly rough ones, indicate that a slackening of demand, which has already begun, is likely to become pronounced within a few months—again, barring new interruptions.

Although there has been much talk recently about other OPEC countries taking over the Saudi-Kuwaiti function of reducing oil shipments enough to keep present real prices stable, we are skeptical that sufficient action will occur to carry out those declared intentions. Except for the Saudis there is little in OPEC's history to assure much compliance with any proposals for coordinated production cutbacks.

Energy actions now under way, world-wide, should provide increasing protection

against a renewal of "leapfrogging" prices. OPEC supplied 25% of the world's energy in 1973. By 1985, it is likely to have declined to 18%. Each oil crisis has led to increased stockpiling and more exploration; the net effect is to increase both stock and production capacity, and to make the next interruption more tolerable.

In every nation consumers have become conscious of the sensitive nature of international oil prices. Their concerns unleash political and economic forces which will influence the international markets. These forces will constrain further price increases, unless another major interruption occurs. Iran remains the most precarious oil exporter; its present oil production appears to have slipped below 3 MBPD. Substantial further slippage, although not expected, could once more tighten the market.

None of this discussion of underlying economic facts takes away from the fragility and danger of the current international oil market. There are great political dangers that threaten supply and therefore prices. Even fears can alter the balance. A mere one-million barrel Iranian shortfall, 6% of a year's world oil production, started the chain of developments which doubled world oil prices last year. There is great and continuing cause for concern about oil supply—but it should be accurate and informed concern.

During the 1990s contributions from synthetic fuels, heavy oils, unconventional sources of natural gas and possibly solar devices, as well as continued increases in efficiency, can reduce our import dependence. However, during the 1980s while these technologies are being nursed into the commercial arena, only concentration upon production from conventional sources, and upon conservation of liquid fuels, can keep the OPEC wolf at bay.

*Mr. Brown is director of technological studies and Mr. Singer is deputy director of Hudson Institute.*